

Staff Briefing Papers

Meeting Date **October 24, 2019**

Agenda Item **8

Company Otter Tail Power Company (Otter Tail)

Docket No. **E017/M-19-256**

In the Matter of Otter Tail Power Company's 2018 Demand-Side Management Financial Incentive and Annual Filing to Update the Conservation-Improvement Program Rider

- Issues
1. What 2018 tracker account balance should be approved by the Commission?
 2. What level of Shared Savings financial incentive should the Commission approve for Otter Tail's 2018 CIP achievements?
 3. What Conservation Cost Recovery Adjustment (CCRA) should the Commission approve for 2019/2020?
 4. Should the Commission approve the request for a variance to Minnesota Rule 7820.3500 (E) and (K) to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills? And
 5. Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?

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**Relevant Documents****Date**

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| Order determining Ratemaking Treatment of the Utility CIP Project Costs and Requiring Further Filings Docket No. E,G-999/DI-12-1342 | July 16, 2013 |
| Commission Order Approving Tracker Account, Approving Financial Incentive Subject to True-Up, Setting CCRA, and Granting Variance Docket No. E-017/M-18-119 | October 30, 2018 |
| Initial Filing – 2018 DSM Financial Incentive/CIP Project Rider and 2018 Conservation Improvement Project Status Report Correction filed April 1, 2019 | April 1, 2019 |
| Comments of Minnesota Department of Commerce (DOC) | May 31, 2019 |
| Reply Comments Otter Tail Power | June 24, 2019 |
| Reply Comments- Minnesota Department of Commerce (DOC) | July 26, 2019 |
| Reply Comments of Otter Tail Power Company | August 19, 2019 |
| Comments of the Office of the Attorney General (OAG) | September 12, 2019 |
| Minnesota Department of Commerce Response Letter | October 1, 2019 |

I. Statement of the Issues

1. What 2018 tracker account balance should be approved by the Commission?
2. What level of Shared Savings financial incentive should the Commission approve for Otter Tail's 2018 CIP achievements?
3. What Conservation Cost Recovery Adjustment (CCRA) should the Commission approve for 2019/2020?
4. Should the Commission approve the request for a variance to Minnesota Rule 7820.3500 (E) and (K) to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills? And
5. Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?

II. Background

On April 1, 2019, Otter Tail Power Company (Otter Tail, OTP, or the Company) submitted its annual Conservation Improvement Program (CIP) filing (Petition) for 2018 with the Minnesota Public Utilities Commission (Commission) in Docket No. E017/M-19-256. The Petition contained the following requests:

- Approval to include Otter Tail's Company-Owned Light Emitting Diode (LED) Street Light project expenses, less any rate of return for the project, within the financial incentive mechanism;
- Approval of a Demand Side Management (DSM) financial incentive of \$3,004,311;
- Approval of proposed recoveries and expenditures in the Company's CIP tracker account during 2018 resulting in a year-end 2018 balance of \$5,994,017;
- Approval of a 2019/2020 Conservation Cost Recovery Adjustment (CCRA) of \$0.00710 per kWh for bills rendered on and after October 1, 2019; and
- Approval of a variance to Minnesota Rule 7820.3500 (E) and (K) to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills.

On May 31, 2019, the Department filed Comments analyzing Otter Tail's proposal.

On June 24, 2019, Otter Tail filed Reply Comments responding to the Department's requests and recommendations. In these reply comments, the Company requested that the Commission exempt it from the CIP-expenditure cap for 2018 and 2019.

On August 19, 2019, Otter Tail filed a response to the Department's July 26, 2019 reply comments. Otter Tail provided discussion on areas of agreement and disagreement with the Department.

On September 12, 2019, the Office of the Attorney General (OAG) filed comments opposing Otter Tail's request to remove the cap that limits a utility's incentive award to 30 percent of its total spending on conservation improvements.

The DSM Financial Incentive is structured as follows:

- A. For electric utilities, the plan is modified to do the following:
 - 1) Authorize financial incentives for a utility that achieves energy savings of at least 1.0 percent of the utility's retail sales.
 - 2) For a utility that achieves energy savings equal to 1.0 percent of retail sales, award the utility a share of the net benefits.
 - 3) For each additional 0.1 percent of energy savings the utility achieves, increase the net benefits awarded to the utility by an additional 0.75 percent until the utility achieves savings of 1.7 percent of retail sales.
 - 4) For savings levels of 1.7 percent and higher, award the utility a share of the net benefits equal to the Net Benefits Cap.

- B. For gas utilities, the plan is modified to do the following:
 - 1) Authorize financial incentives for a utility that achieves energy savings of at least 0.7 percent of the utility's retail sales.
 - 2) For a utility that achieves energy saving equal to 0.7 percent of retail sales, award the utility a share of the net benefits.
 - 3) For each additional 0.1 percent of energy savings the utility achieves, increase the net benefits awarded to the utility by an additional 0.75 percent until the utility achieves savings of 1.2 percent of retail sales.
 - 4) For savings level of 1.2 percent and higher, award the utility a share of the net benefits equal to the Net Benefits Cap.

The CIP incentive mechanism was structured so that the two caps were phased down in the following manner over the three years of the program (The percentages represent financial incentive as percentage of net benefits and CIP expenditures):

For All Utilities - The Following Net Benefit Caps:

1. 13.5 percent in 2017
2. 12.0 percent in 2018
3. 10.0 percent in 2019

For All Utilities - The Following Percent of CIP Expenditure Caps:

1. 40 percent in 2017
2. 35 percent in 2018
3. 30 percent in 2019

III. Parties' Comments

1. What December 31, 2018 tracker account balance should be approved by the Commission?

Otter Tail: In the Department's July 26, 2019 Reply Comments the Department included 2018 CIP Tracker for Otter Tail's 2018 month CIP expenses, recoveries, and sales. Otter Tail has reviewed this tracker and believes two adjustments need to be made. First the Annual Summary balance of \$19,448,454 does not include the \$3,745. Also, the \$3,745 adjustment to January 2018 does not include a carry charge rate applied to it which results in an additional \$8. As such, Otter Tail is recommending a December 31, 2019 end tracker balance of \$5,994,439.

Subsequently, the DOC provided a corrected number of \$5,994,429. Otter Tail has indicated to Staff that it will accept this number.

Otter Tail has reviewed the Department's request for Otter Tail to include sales and recoveries by month and believes the request is for 2018 or the CIP year just completed. Otter Tail has no issues with including both sales and recoveries for the CIP actual year in future filings and will plan to do so on a forward basis. (Otter Tail's August 19, 2019 Reply Comments at Page 5)

DOC: In its May 31, 2019 Comments, the Department noted a discrepancy between the December ending balance of the approved 2017 CIP Tracker, and the proposed January 2018 beginning balance. The Department recommended that the Company set its 2018 beginning tracker balance to the 2017 ending balance approved by the Commission, and provide adjustments to the 2018 CIP tracker, if needed.

In its June 24, 2019 Reply Comments, the Company explained that the discrepancy was due to two errors from the 2017 CIP tracker: the first was a data entry error, and the second was a carrying charge rate error (OTP used 2.55% instead of the rate-case approved 2.5549%). Instead

of proposing an adjustment to the 2018 CIP tracker as recommended by the Department, Otter Tail requested that the Commission approve an amended 2017 CIP tracker, in addition to an updated 2018 CIP tracker.

Table 1 on page eight of the DOC's July 26, 2019 reply comments provide the Company's proposed 2017 and 2018 CIP trackers.

The Department does not support amending the 2017 CIP tracker, which was approved in Docket No. E017/M-18-119. Typically, once a CIP tracker is approved, it is not later amended; rather, adjustments are made going forward. Varying from the expected regulatory construct is not necessary and is likely to cause confusion. For example, a party looking at the 2017 CIP tracker in Docket No. E017/M-18-119 might not know or expect that the same tracker would be re-examined in Docket No. E017/M-19-256. Further, any amendments to the 2017 CIP tracker would necessitate a new review of the 2018 CIP tracker and proposed CCRA. Adding these additional steps creates further regulatory resources, potential for error, and transparency issues. Instead, any needed adjustments to the 2017 CIP tracker should be captured in the 2018 CIP tracker.

The Department also recommends that the Commission require the Company to, in future filings, track monthly sales as well as recoveries by revenue source (base rates or CCRA) in its CIP tracker. (DOC's July 26, 2019 Reply Comments at Pages 7&8).

The DOC has subsequently provided a corrected number to Staff of \$5,994,429. Otter Tail has agreed to this number.

2. What level of Shared Savings financial incentive should the Commission approve for Otter Tail's 2018 CIP achievements?

Otter Tail: Otter Tail requests the inclusion of the Company's LED Street Light project expenses, less any rate of return for the project within the financial incentive mechanism. This recognition is reflected in adjustments to the CIP tracker account of 2018 financial incentive of \$3,004,311 based on total 2018 eligible CIP expenditures of \$9,008,847 (2018 financial incentive of \$3,153,096 reduced by \$148,785¹ to account for actual 2018 LED Street Light expenses).

¹ To account for the fact that the full budgeted 2017 expenditures (\$739,375) were not spent (\$0 in 2017 and \$367,411 in 2018), the Company proposed an adjustment to the 2018 financial incentive. The Company calculated the amount of incentive associated with the shortfall that was approved in last year's incentive as \$148,786, or 40% of the difference between 2017 budgeted expenditures and 2018 actual expenditures ($\$739,375 - \$367,411 = \$371,964$). As a result of this proposed adjustment to the 2018 incentive, the Company proposed an incentive that represents 33% of expenditures (equal to \$3,004,311) rather than an incentive reflecting the 2018 allowed expenditure cap of 35% (equal to \$3,153,096).

However, Otter Tail prefers an exemption for Otter Tail from the performance incentive's expenditure cap provision for 2018 and 2019. This results in a performance incentive payout of 12 percent of net benefits or \$4,044,350 for 2018 CIP achievements (2018 financial incentive of \$4,153,135 reduced by \$148,785 to account for actual 2018 LED Street Light expenses). (Otter Tail Power's August 19, 2019 reply comments at pages 11&12)

A. Otter Tail's Request that the Commission Exempt the Company from Shared Savings Expenditure Cap

Otter Tail believes the current CIP performance incentive mechanism, when applied to Otter Tail's high-performance results, is not consistent with Minnesota statute, harms the Company and potentially its customers, and does not serve the public interest. The mechanism, with the new spending cap provision, is counter-intuitive to cost-effective conservation offerings since it could encourage an otherwise high-performing utility to increase program costs, simply to increase the Company's financial incentive. (Otter Tail Power's June 24, 2019 reply comments at page 5)

Removing the spending cap provision provides more net benefits to customers. Retaining the spending provision provides no additional program benefits to customers and creates a disincentive for utilities to run cost-effective programs. The spending cap provision in its current form creates different drivers for utilities likely creating different outcomes. (Otter Tail Power's June 24, 2019 reply comments at page 7)

Otter Tail performance is the highest in the state at 4.03 percent energy savings, but the Company may receive the lowest performance incentive award at 7.9 - 9.1 percent of net benefits. Otter Tail understands the reason for the spending cap provision was to limit a utility's performance incentive, but a full understanding of the impacts of the spending cap provision were unknown when the Commission approved the provision in 2016 and is now producing unintended consequences. All analysis at the time of the Commission's decision was based on forecasted performance. Now that actual results can be examined it makes sense for the Commission to review if the spending cap provision is truly in alignment with Minnesota Statute § 216B.16 Subd. 6c and serving the public interest. Otter Tail's record achievement shows its strong commitment to CIP performance. Eligibility toward an equitable CIP performance incentive counterbalances Otter Tail's inherent incentive to sell more energy. (Otter Tail Power's June 24, 2019 reply comments at pages 8 & 9)

In this docket Otter Tail is requesting an exemption from the spending cap provision due to it conflicting with statute, creating a non-equivalent to other utilities performance incentive, and incentivizing non-cost-effective program spending. A similar exemption to the financial incentive mechanism was granted by the Commission to Minnesota Power under the previous financial incentive mechanism in 2013. (Otter Tail Power's June 24, 2019 reply comments at pages 8 & 9)

Otter Tail believes it is currently in a similar position as Minnesota Power in 2013 and proposes a similar exemption request. With the current spending cap provision, Otter Tail cannot achieve a similar level of payout as the other electric utilities unless it pursues non-cost-effective program spending. Otter Tail requests a two-year exemption to the spending cap provision for 2018 and 2019. The financial incentive mechanism is scheduled to be reviewed again this summer with the Department filing a proposal on July 1, 2019. The Commission's decision in that proceeding will likely determine the CIP performance incentive for 2020 and beyond.

B. LED Expenditures Included in the Incentive Expenditure Cap

In Otter Tail's 2017 CIP Financial Incentive filing, Docket No. E-017/M18-119, the Company proposed to include expenses from the Company's LED Street Light project within the financial incentive mechanism. The LED Streetlights are owned by Otter Tail but installed as an illumination service at the request of customers. The Company does not include any energy savings or net benefits from the LED Street Light project towards the financial incentive, but including the expenses unlocks other net benefits, from other programs that are financial incentive eligible, to be included in the financial incentive. (Otter Tail Power April 1, 2019 Initial Filing at page 6)

MPUC order points 1. and 2. in docket number E,G-999/DI-12-1342 discuss utility participation in CIP and eligibility towards financial incentives. Otter Tail believes the proposal to include LED expenses is in compliance with these two order points. Order point 1. from the MPUC's July 16, 2013 decision is as follows:

1. The Commission hereby finds that utilities may participate in CIP projects at their own facilities and that the associated customer and/or vendor incentives, program delivery, evaluation, marketing, and administrative costs may be recovered through the CIP ratemaking process if the costs are approved by the Department as part of CIP and provided a utility demonstrates that its participation in CIP does not result in double recovery of ratepayer funds. This finding does not extend to electric utility infrastructure projects governed by Minnesota Statutes section 216B.1636. (Otter Tail Power April 1, 2019 Initial Filing at page 7)

Concerning the first order point on the issue of double recovery Otter Tail is clearly not double recovering. The CIP rebate paid to Otter Tail reduces rate base and Otter Tail's ability to earn a rate of return. The rebate is essentially a rebate back to the customers lowering their future obligations to pay for rate base. The return on the remaining rate base through CIP which the MPUC approved in its November 2017 decision in 17-152 has not been included as an expense towards the financial incentive in this proceeding. Otter Tail and the Department have previously agreed those expenses, \$18,915.68 in 2018, are not eligible expense towards the CIP financial incentive and have been removed from the financial incentive in this proceeding.

Otter Tail also believes double recovery does not exist because the proposed financial incentive is calculated based on net benefits strictly from other programs that are eligible to be included towards the financial incentive. The LED Street Light project expenses are simply unlocking these net benefits from other programs. It is important to note that Otter Tail's 2018 programs set a state record for energy savings as a percent of sales, but 24 percent of the net benefits from these programs do not count towards the Company's financial incentive simply because Otter Tail diligently managed program costs and didn't spend more money. Otter Tail believes no double recovery exists since the Company's proposed financial incentive is strictly coming from other eligible programs' net benefits.

Order point 2. from the MPUC's July 16, 2013 decision is as follows:

2. The Commission further finds that energy savings and net benefits resulting from utility participation in CIP projects at their own facilities shall not count toward the determination of the utility's DSM financial incentive.

Otter Tail is also in compliance with order point two since Otter Tail is not counting any energy savings or net benefits from Otter Tail's own facilities towards the financial incentive. Only expenses from the LED Street Light project are being included. All energy savings and net benefits included in the proposed financial incentive are from non-Company owned and financial incentive eligible projects. (Otter Tail Power April 1, 2019 Initial Filing at page 7)

In the MPUC's order from July 16, 2013, the Commission Action area further describes the MPUC's intent of their order points. The first paragraph on page 4 states,

The purpose of DSM financial incentive is to neutralize, at least in part, the significant disincentive to conservation posed by lost energy sales. These incentives compensate utility for a portion of sales lost to conservation and have proven to be effective tools for maximizing utility participation in conservation efforts. (Otter Tail's April 1, 2019 Initial Filing at Page 8)

Otter Tail agrees with the MPUC's assessment of applying a financial incentive only in instances where there are lost sales. Otter Tail believes it has clearly proven that the financial incentive proposal is tied to lost sales. As stated above previously, 24 percent of Otter Tail's net benefits are not eligible towards financial incentive purely due to the Company not spending substantially more money. These net benefits are being driven from significant lost sales from Otter Tail's record-breaking year of energy savings. Otter Tail's proposal is simply to allow expenses from the LED Street Light program to be included so other financial incentive eligible program net benefits can be allowed towards the financial incentive to offset a portion of the significant lost sales. (Otter Tail's April 1, 2019 Initial Filing at Page 8)

The July 16, 2013 Commission Order provides guidelines for utility participation in CIP, but it does not limit the eligibility of expenses from utility projects being applied towards a spending

cap provision. With the Order being silent on this issue, the Company asks the Commission to not limit the incentive as proposed by the Department in this docket.

Otter Tail is not including net benefits from Company-owned projects towards the performance incentive. Otter Tail offers there are other CIP programs that have performance incentive qualifying expenses but no inclusion of net benefits towards the financial incentive. Otter Tail has demonstrated that significant lost sales revenues have occurred in both 2017 and 2018 that are not being counterbalanced with performance incentive compensation. Lastly, including expenses towards the performance incentive mechanism encourages utilities to pursue Company projects that might not otherwise be pursued. (Otter Tail's June 24, 2019 reply comments at Page 5)

A. Otter Tail's Request that the Commission Exempt the Company from Shared Savings Expenditure Cap

DOC: Otter Tail cited three reasons for why the Commission should approve its request. First, Otter Tail claimed that the incentive expenditure cap conflicts with Minnesota Statutes § 216B.16 Subd. 6c. Second, Otter Tail claimed that the expenditure cap treats Otter Tail differently from Minnesota's two other electric IOUs. Third, Otter Tail claimed that the expenditure cap incentivizes non-cost-effective program spending. Based on its request for exemption from the spending cap, Otter Tail now requests an incentive of \$4,004,350, an amount equal to 43% of the Company's 2018 total proposed CIP expenditures and approximately \$1 million more than the \$3,004,311 that the Company requested in its April 1, 2019 Petition. (DOC's July 26, 2019 Reply Comments at Pages 11)

Otter Tail made the unreasonable proposal that the Commission exempt the Company from the Shared Savings CIP expenditures cap for 2018, a year that is already complete, and for 2019, which is already half over. The Department concludes that Otter Tail's request to modify its incentive mechanism should be rejected on grounds that any change to the incentive mechanism should only be made on a prospective basis. Further, Commission approval of the request would harm Otter Tail's ratepayers by requiring them to pay Otter Tail \$1 million more than the Company's initial request for 2018 alone. In addition, approval of Otter Tail's request could lead to CenterPoint proposing that the Commission approve an additional \$9.2 million for its 2017 CIP achievements.

Finally, the Department concludes that Docket No. E,G999/CI-08-133 is the proper venue for Otter Tail to propose changes to the incentive mechanism, and only on a prospective basis. (DOC's July 26, 2019 Reply Comments at Pages 24&25)

OAG: The OAG's comments only address Otter Tail's request to exempt it from the CIP-expenditure cap for 2018 and 2019. On April 1, 2019, Otter Tail filed its annual petition to update the CIP rider, the billing mechanism through which it recovers CIP costs, including incentive payments. The Company requested approval to recover some \$3 million in incentives for its 2018 CIP activities. In reply comments, however, the Company made a new request: It asked the Commission to exempt it from the CIP-expenditure cap for 2018 and 2019. The

immediate effect of granting this request would be to give Otter Tail an additional \$1 million for 2018. (OAG's September 12, 2019 Comments at Page 6)

Otter Tail wants the Commission to throw out the CIP-expenditure cap because it works. In 2017 and 2018, the cap protected ratepayers by limiting utilities' DSM financial incentives to 40 percent and 35 percent of their individual CIP investments. And it did so while simultaneously spurring utilities to achieve record levels of energy savings. This year, the CIP expenditure cap will be fully phased in at 30 percent. Even at this reduced level, the cap allows utilities to earn a rate of return on CIP investments that is far beyond anything they could hope to earn on ordinary, rate-base investments. (OAG's September 12, 2019 Comments at Page 8)

The OAG argued that the Commission should deny Otter Tail's request because it is an untimely petition for reconsideration, because the CIP-expenditure cap operated as intended and treated Otter Tail fairly, and because making an exception for Otter Tail would be unfair to other utilities and would invite similar requests in the future. (OAG's September 12, 2019 Comments at Page 9)

B. LED Expenditures Included in the Incentive Expenditure Cap

DOC: Otter Tail requested recovery of a DSM financial incentive of \$3,004,311 for 2018. This figure assumes that 2017 and 2018 LED expenditures are included in the calculation of the financial incentive. Since the Commission provisionally approved 2017 budgeted (but not actual) expenditures towards the 2017 financial incentive, subject to further discussion in the instant docket, the Company proposed an adjustment of (\$148,786) to reflect the difference between budgeted versus actual expenditures. (DOC's July 26, 2019 Reply Comments at Page 6)

In its May 31, 2019 Comments, the Department recommended that the Commission approve a DSM financial incentive of \$2,728,752. This figure assumes that neither 2017 nor 2018 LED expenditures are included in the calculation of the financial incentive. The Department recommended financial incentive includes the Department's recommended adjustments for all 2017 and 2018 LED expenditures, but does not include Otter Tail's proposed adjustment for budgeted versus actual 2017 LED adjustments.

In its June 24, 2019 Reply Comments, Otter Tail continued to request a 2018 financial incentive of \$3,004,311, based on the Company's request to include LED expenditures in the financial incentive calculation. (DOC's July 26, 2019 Reply Comments at Page 6)

The Department is not convinced by Otter Tail's arguments that Company-owned LED CIP expenditures should count when applying the financial incentive expenditure cap. Therefore, the Department continues to recommend a DSM financial incentive of \$2,728,752, based on the Department's recommendation to not permit LED expenditures towards the financial incentive. However, if the Commission determines that Otter Tail's LED street lighting expenditures should be included when calculating the financial incentive, the Department is not opposed to the Company's proposal for the Commission to approve an adjusted 2018 incentive of \$3,004,311. (DOC's July 26, 2019 Reply Comments at Page 7)

In its Petition, Otter Tail stated that the Commission's July 16, 2013 Order allows a utility to participate in its own CIP programs, provided no double recovery exists. Therefore, the Company argued, Otter Tail should be permitted to count LED expenditures when applying the expenditure cap. The Company cited Order Point 1 from the Commission's July 16, 2013 Order. In its May 31, 2019 Comments, the Department pointed out that Order Point 1 is not applicable to the current issue, since the Order Point does not address whether or not CIP expenditures at a utility's own facilities may count when applying the financial incentive expenditure cap. The Department concluded that Otter Tail had not demonstrated that past Commission Orders support including expenditures on Company-owned CIP projects in the financial incentive calculation.

In its June 24, 2019 Reply Comments, Otter Tail agreed that Order Point 1 is not relevant because double recovery is not at issue in the current proceeding. Otter Tail then argued that since no double recovery exists, the Commission should permit the Company to count the LED expenditures when applying the expenditure cap, stating:

As long as there is no double recovery, the Commission should support Company project expenses towards the financial performance incentive to encourage cost-effective Company owned projects which can produce immense customer benefits.

Again, the Department notes that the absence of double recovery is not the standard for whether or not the LED expenditures should count when applying the financial incentive expenditure cap. Order Point 1 in the Commission's July 16, 2013 Order is not relevant to the discussion at hand, and thus the absence of double recovery does not mean the Commission should approve Otter Tail's request. Thus, the Department again concludes Otter Tail has not demonstrated that past Commission Orders support including expenditures on Company owned CIP projects in the financial incentive calculation. (DOC's July 26, 2019 Reply Comments at Pages 2 & 3)

Additionally, Otter Tail argued that while the Commission's July 16, 2013 Order specified that energy savings and net benefits cannot count towards the financial incentive, the Order did not specify the same for expenditures. The Company cited Order Point 2 of that Order, which states:

The Commission further finds that energy savings and net benefits resulting from utility participation in CIP projects at their own facilities shall not count toward the determination of the utility's DSM financial incentive.

In its May 31, 2019 Comments, the Department agreed that expenditures are not explicitly mentioned in the Order Point, but noted that the nature and context of the financial incentive at the time of the July 16, 2013 Order was important to understand the Order Point. The Department noted two things in particular:

- At the time of the July 16, 2013 Order, the financial incentive was calculated based on net benefits and energy savings. There was no expenditure cap, as

there is now, and thus no need to specify whether expenditures should count towards the financial incentive.

- Net benefits are calculated by subtracting avoided costs from actual costs, and actual costs comprise both the financial incentive and expenditures. Since net benefits is included in the July 16, 2013 Order, and one component of net benefits is expenditures, that Order indirectly incorporates expenditures.

The DOC pointed out that Otter Tail did not address the first issue.

Otter Tail did address the Department's second point. The Company argued that there are instances where expenditures count towards the spending cap, but not towards the net benefits cap. Specifically, OTP pointed to the following expenditures: POP Solar, House Therapy, and Regulatory Assessments. Otter Tail argued that the proposed treatment of the Company-owned LED project expenses are no different from the treatment of these other program expenses, and thus should be approved by the Commission.

The Department disagrees that the Company-owned LED project expenses should be treated the same as POP Solar, House Therapy, and Regulatory Assessment expenses; while the LED project occurs at the Company's own facilities, the other projects do not. The Commission's July 16, 2013 Order is specific to CIP projects at a utility's own facilities, and so is not applicable to these other projects. Thus, the Department continues to conclude that the Commission's July 16, 2013 Order may indirectly include expenditures because it includes net benefits. (DOC's July 26, 2019 Reply Comments at Pages 3 & 4)

Finally, the Company argued that one purpose of the DSM incentive is to compensate the utility for lost sales due to conservation. Otter Tail argued that since the Company has experienced lost sales, it should be permitted to include the LED expenditures towards the financial incentive expenditure cap.

In its May 31, 2019 Comments, the Department noted two important points:

- The CIP incentive is one mechanism in a suite of regulatory strategies designed to encourage conservation. However, its purpose is to incentivize utilities to maximize the amount and cost effectiveness of energy savings, not to mitigate lost sales due to conservation. Instead, the most appropriate regulatory mechanism to make up for lost sales is the decoupling mechanism.
- Otter Tail is not experiencing a loss in profit due to the LED street lighting project. This is because the street lighting rates were not changed as the Company switched to LEDs, and because street lighting rates are a monthly per-light fixed charge rather than a variable per-kWh charge. As a result, the Company should only be experiencing cost savings from the LED program, not lost sales.

With respect to the first point, Otter Tail appeared to maintain that the financial incentive should compensate the Company for lost sales revenue, stating:

Otter Tail has demonstrated that significant lost sales revenues have occurred in both 2017 and 2018 that are not being counterbalanced with performance incentive compensation.

The Department continues to conclude that the decoupling mechanism is the more appropriate tool for addressing lost sales due to conservation. However, since Otter Tail stated that it is experiencing significant lost sales revenues, the Department encourages the Company to file a petition with the Commission for a decoupling mechanism.

With respect to the Department's second point, Company argued that the Department is ignoring lost profits due to the portion of the financial incentive that is disallowed because of the expenditure cap.

On page 10 of its May 31, 2019 Comments, the Department noted that, in the case of the LED program, "the Company is not experiencing a loss in profit due to conservation." As the Company noted, this statement is incorrect, as the Company is indeed experiencing a loss in profit due to conservation because of the financial incentive expenditure cap. Instead, the Department should have stated that in the case of the LED program, "the Company is not experiencing a loss in sales revenue due to conservation." The Department apologizes for the oversight.

However, the Department is still not sympathetic to Otter Tail's argument. Otter Tail did not address the fact that the LED program does not result in lost sales revenue due to conservation. Furthermore, even if the Department agreed that the financial incentive is the appropriate mechanism to compensate for lost sales due to conservation (which it does not), "lost" financial incentive should not be treated the same as lost sales. Otter Tail is stating that because of a lower financial incentive (and thus a loss in profit), the Company should be permitted to earn a larger financial incentive (by counting the LED expenses towards the expenditure cap). This is nonsensical. Therefore, the Department continues to conclude that even if it were appropriate to use the financial incentive as a mechanism to account for lost sales revenue, the Company has not demonstrated that it has experienced loss sales revenue as a result of the LED program. DOC's July 26, 2019 Reply Comments at Pages 4 - 6)

3. What Conservation Cost Recovery Adjustment (CCRA) should the Commission approve for 2019/2020?

Otter Tail: In Otter Tail's initial April 1, 2019 filing in this docket the Company requested an increase to the CCRA surcharge of 18.3 percent. Increasing the rate from \$0.00600/kWh to \$0.00710/kWh. In the Department's July 26, 2019 Reply Comments, the Department recommended a CCRA surcharge increase of 15 percent or \$0.006900/kWh. Otter Tail has reviewed the Department's recommendation and agrees that if the Commission determines expenses and net benefits from the combination of Company-owned projects and customer

projects do not count towards the financial incentive then the CCRA surcharge should be \$0.006900/kWh. However, if the Commission finds that the combination of Company-owned and customer projects are eligible towards the financial incentive or if the Commission approves Otter Tail's requested exemption from the expenditure cap provision for 2018 and 2019 then Otter Tail requests the Commission approve its initial request of \$0.00710/kWh, effective October 1, 2019 (Otter Tail's August 19, 2019 Reply Comments at Page 5)

DOC: For October 2019 through September 2020, Otter Tail proposed an 18.3 percent increase in its CCRA surcharge from \$0.00600/kWh to \$0.00710/kWh.

In its June 24, 2019 Reply Comments, the Company did not provide the requested information. As such, the Department calculated an alternative CCRA projection, provided in Attachment B and summarized in Table 3 of the DOC's July 26, 2019 reply comments. This alternative CCRA would be set at \$0.006900, a 15 percent increase over the current surcharge.

The Department's proposed calculation results use the same CIP expenses, forecasted incentive, base rate recoveries, and carrying charge rate assumed by the Company. The Department updated the beginning balance to reflect its recommendations concerning the Company's 2018 CIP tracker and 2018 financial incentive. With the updated information, the Department calculated slightly different totals for carrying charges, CCRA recoveries, and ending balance than the Company's proposal. The Department's proposed CCRA would bring the tracker balance closer to zero over the course of time the CCRA is in place, while incurring relatively low carrying charges.

The Department therefore recommends the Commission approve a CCRA rate of \$0.0069, effective October 1, 2019. (DOC's July 26, 2019 Reply Comments at Pages 9&10)

4. Should the Commission grant the request for a variance to Minnesota Rule 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills?

Otter Tail: Otter Tail recommends that grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket (Otter Tail's August 19, 2019 Reply Comments at Page 12)

DOC: The DOC recommends that the Commission grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket. (DOC's July 26, 2019 Reply Comments at Page 25)

5. **Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?**

Otter Tail: Otter Tail recommends that the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter. Otter Tail's (August 19, 2019 Reply Comments at Page 12)

DOC: The DOC recommends that the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter. (DOC's July 26, 2019 Reply Comments at Page 25)

IV. Staff Analysis

Staff acknowledges that there is no controversy for issues 1, 4, and 5. With respect to issue 1, the only issue maybe an arithmetic issue. It appears that the DOC when calculating ending tracker balance did not include (although it was listed, \$3,795) the Adjustment from 2017 Data Entry Error. In addition, the DOC did not include the Otter Tail's true-up (approximately \$8) for understating the 2017 carrying charges. As such, Staff believes that the correct ending tracker balance should be \$5,994,439.

Issues 4 and 5 are administrative issues and are easily addressed. The remaining issues are addressed below:

Shared Savings Financial Incentive

A. Otter Tail's Request that the Commission Exempt the Company from Shared Savings Expenditure Cap

On April 1, 2019, Otter Tail filed its annual petition to update the CIP rider, the billing mechanism through which it recovers CIP costs, including incentive payments. The Company requested approval to recover \$3,004,311 (2018 financial incentive \$3,153,096 reduced by \$148,785 to account for the reduction required to be made to the 2017 financial incentive for actual 2018 LED street light expenses) in incentives for its 2018 CIP activities. In its June 24, 2019 reply comments, the Company modified its original request. The Company asked the Commission to exempt it from the CIP-expenditure cap for 2018 and 2019.

The effect of granting this request would be to provide Otter Tail an additional approximately \$1 million for 2018. As approved by the Commission, a utility's shared savings is constrained by the

lesser of the CIP expenditure cap (35% in 2018) or the net benefit cap (12% in 2018). As a result for 2018, the expenditure cap is binding at \$3,153,096. However, if Otter Tail would be exempted from the expenditure in 2018, the Net benefit cap would be binding at \$4,153,135. Also, if the Commission determines that Otter Tail is exempt from the expenditure cap, the LED street lighting issue is eliminated because the expenditure cap is no longer relevant.

With respect to the merits of Otter Tail's request, Staff agrees with the DOC and the OAG that the purpose of the expenditure cap was to provide an additional safeguard for ratepayer and to keep the shared savings incentive in line with other states. As such, Staff agrees with the comments of the OAG in this context:

First with respect to the purpose of the expenditure cap:

The CIP-expenditure cap was designed to rein in utility incentives by limiting their size relative to total CIP expenditures. In Otter Tail's case, it did exactly that. Without the CIP expenditure cap, Otter Tail would have received 12 percent of net benefits, or \$4.2 million. But because of the cap, Otter Tail instead received 35 percent of its CIP expenditures, or \$3.2 million, saving the Company's ratepayers \$1 million in incentive payments. Otter Tail is unhappy with the CIP-expenditure cap because it served its intended purpose. (OAG September 12, 2019 comments at page 10)

Second regarding Otter Tail's treatment relative to other utilities under the expenditure cap:

Under the Commission's August 2016 order, all Minnesota utilities are subject to the same CIP-expenditure cap. Otter Tail claims that it is the only utility impacted by the cap. This claim is not only irrelevant, but also misleading. While it is true that Otter Tail was the only utility to reach the CIP-expenditure cap in 2018, both Otter Tail and CenterPoint Energy hit the cap in 2017. That year, the cap reduced Otter Tail's incentive award by roughly \$500,000, while CenterPoint's award was reduced by fully \$9.2 million as a direct result of the CIP expenditure cap. Despite experiencing much more of an impact from the cap than Otter Tail, CenterPoint never asked for special treatment from the Commission. (OAG September 12, 2019 comments at pages 10 and 11)

Finally, staff agrees with the OAG that the other Utilities would not sit idly by and continue to play by the original rules set if they felt disadvantaged:

Minnesota utilities rely on the shared-savings incentive formula in planning their CIP investments. Occasionally, the formula results in some utilities, like Otter Tail and CenterPoint, receiving a lower incentive award than they might have hoped for. But making ad hoc exceptions to the formula when it suits one utility's purposes would be inequitable and would encourage similar requests from other utilities in the future when results do not go their way. (OAG September 12, 2019 comments at page 11)

As such, the Commission should deny Otter Tail's request to exempt it from the CIP expenditure cap.

B. LED Expenditures Included in the Incentive Expenditure Cap

With Respect to Otter Tail's LED Streetlight project, the Commission will need to determine if this project is eligible expense as a CIP project. Below is some information the Commission may want to consider. In its July 16, 2013 Order, the Commission took the following action regarding CIP participation by utilities:

The Commission concurs with the parties that utilities should be allowed to participate in CIP. Ratepayers will benefit from incentivizing utilities to make cost-effective energy conservation improvements to their facilities because the cost savings resulting from these improvements will be passed on to the ratepayers. The Commission therefore finds that utilities may participate in CIP projects at their own facilities and recover the associated customer and/or vendor incentives, program delivery, evaluation, marketing, and administrative costs through the CIP ratemaking process. To be recovered through the CIP ratemaking process, an expense must be approved by the Department as part of a utility's CIP.² Utilities must also demonstrate that their participation in CIP will not result in double recovery of ratepayer funds.

In comments filed on June 5, 2017 by the DOC in Docket No. E017/M-17-152, the DOC made the following comments:

The Department notes its understanding that Otter Tail's proposal is to add \$1,303,846 to the CIP tracker each year for 5 years, but that the actual amount included would reflect actual expenses over time..... (DOC June 5, 2017 comment at page 7)

As noted above, CIP expenses added to the CIP tracker are recovered through the CCRA, which is paid for by all CIP-applicable customers. In general, the Department is not opposed to OTP's cost recovery strategy, other than the issues discussed below; the CCRA exists in part to allow the utilities CIP expense/recovery flexibility between rate cases. (DOC June 5, 2017 comment at page 7)

In addition, the DOC concluded that:

Finally, the Department notes that the Department's CIP Staff, who specialize in CIP program budgeting and design, have vetted the budget of the LED Street and Area Lighting Program and did not raise any objections concerning the Company receiving a rebate. As such, the Department defers to their expertise regarding the appropriateness of design of the LED lighting program.

² In a Decision issued on November 3, 2016 and as modified and reaffirmed in Decisions issued on April 26, 2017 and October 18, 2018, the Deputy Commissioner approved kWh savings and projected costs to Otter Tail Power's Company-Owned Street Lighting and Area Lighting program.

Therefore, the Department recommends that the Commission approve recovery of the incentive costs through the CIP Tracker. (DOC June 5, 2017 comment at page 12)

Staff identifies these comments in order for the Commission to have a more complete context in which to make a determination regarding the inclusion of the LED Street Lighting project in CIP expenditures. As result, the Commission needs to determine whether the LED street project expenses are eligible towards the financial incentive spending cap provision. By including these expenses as eligible for the calculation of the expenditure cap, Otter Tail's 2018 Shared Savings financial incentive will be \$3,004,311 (2018 financial incentive \$3,153,096 reduced by \$148,785 to account for the reduction required to be made to the 2017 financial incentive for actual 2018 LED street light expenses).

If the Commission does not deem these expenditures as eligible in the calculation of the financial incentive expenditure cap, Otter Tail's 2018 Shared Savings financial incentive will be \$2,728,752. This amount includes an adjustment of (\$295,750) to the proposed 2018 financial incentive, to remove the portion of the 2017 financial incentive associated with budgeted LED street lighting expenditures.

CCRA

The goal in setting the CCRA is to bring the CIP tracker balance to zero over the course of each year. The purpose of this is to minimize carrying charges borne by ratepayers. However, this objective must be carefully balanced with that of maintaining reasonable rates. With this in mind, the DOC recommended a CCRA of \$0.006900 (a 15% increase from the current CCRA of \$0.006000). This rate will bring the tracker balance close to zero if the Commission approves the DOC's recommendation regarding the shared savings financial incentive.

In the event that the Commission approves either of Otter Tails recommended shared savings financial incentive amounts, a more appropriate level would be the CCRA of \$0.00710 (18.3% increase from the current CCRA of \$0.0060) proposed by Otter Tail. This rate would be more appropriate in light of the goal of moving the tracker balance to zero. In the case of Otter Tail, the tracker balance has not been below \$4.33 million since 2013.

Given the fact of high recent Otter Tail ending tracker balances, Staff recommends that the Commission set the CCRA at \$0.00710 regardless of the of what it determines for Otter Tail's shared savings amount.

V. Decision Options

1. What December 31, 2018 tracker account balance should be approved by the Commission?
 - A. Approve Otter Tail's 2018 CIP tracker account resulting in a December 31, 2018 tracker balance of \$5,994,429 (This number has been agreed to by both DOC and Otter Tail Power)
 - B. Do not approve Otter Tail's 2018 CIP tracker account resulting in a December 31, 2018 tracker balance of \$5,994,429.

2. What level of Shared Savings financial incentive should the Commission approve for Otter Tail's 2018 CIP achievements?
 - A. Approve a Shared Savings financial incentive of \$2,728,752 for Otter Tail's 2018 CIP achievements which **does not** include the LED Street Lightings project's 2018 expenses and **does not** exempt Otter Tail from the performance incentive expenditure cap for 2018 and 2019. (Includes an adjustment of (\$295,750) to the proposed 2018 financial incentive, to remove the portion of the 2017 financial incentive associated with budgeted LED street lighting expenditures.) (DOC recommendation).
 - B. Approve a shared savings financial incentive of \$4,044,350 (2018 financial incentive \$4,153,135 reduced by \$148,785 to account for the reduction required to be made to the 2017 financial incentive for actual 2018 LED street light expenses) This **does** include an exemption for Otter Tail from the performance incentive expenditure cap for 2018 and 2019 (Otter Tail's preferred recommendation).
 - C. Approve a Shared Savings financial incentive of \$3,004,311 (2018 financial incentive \$3,153,096 reduced by \$148,785 to account for the reduction required to be made to the 2017 financial incentive for actual 2018 LED street light expenses) This **does not** include an exemption for Otter Tail from the performance incentive expenditure cap for 2018 and 2019 (Otter Tail recommendation).

3. What Conservation Cost Recovery Adjustment (CCRA) should the Commission approve for 2019/2020?
 - A. Approve a CCRA of \$0.00690 per kWh, to be effective October 1, 2019, or the first day of the month following the Commission's Order in this matter (DOC recommendation).

- B. Approve a CCRA of \$0.00710 per kWh, to be effective October 1, 2019, or the first day of the month following the Commission's Order in this matter.
 - C. Approve a CCRA of \$0.00710 per kWh, to be effective October 1, 2019, or the first day of the month following the Commission's Order in this matter. Otter Tail's recommendation if the Commission determines that the combination of Company-owned and customer projects are eligible towards the financial incentive (LED street lighting project) or if the Commission approves Otter Tail's requested exemption from the expenditure cap provision for 2018 and 2019 (Otter Tail's recommendation).
4. Should the Commission grant the request for a variance to Minnesota Rule 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket to allow Otter Tail to continue to combine the Fuel Clause Adjustment (FCA) with the Conservation Improvement Adjustment on customer bills?
- A. Grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket.
 - B. Do not grant Otter Tail a variance to Minnesota Rules part 7820.3500 (K) and a variance to Minnesota Rules part 7825.2600 for one year after the issue date of the Commission's Order in the present docket.
5. Should the Commission require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter?
- A. Require Otter Tail to submit a compliance filing, within 10 days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter.
 - B. Require Otter Tail to submit a compliance filing, within a different number of days of the issue date of the Order in the present docket, with revised tariff sheets reflecting the Commission's determinations in this matter.

VI. Staff Recommendation

Staff recommends that the Commission adopt alternatives 1A, 3B, 4A, and 5A.